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Supreme Court of the United States.

OCTOBER TERM, 1948.

No.

LEE M. FRIEDMAN,
Petitioner,
v.
DENIS W. DELANEY, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MASSACHUSETTS,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, Lee M. Friedman, respectfully presents to this Court this, his petition for a writ of certiorari, addressed to the United States Court of Appeals for the First Circuit, commanding such Court and the clerk thereof to certify to this Court the record and proceedings of this case in said Court in which case your petitioner was appellant and the respondent Collector was appellee, together with the opinions therein of said Court of Appeals, for review and determination of said cause by this Court.

This was an action originally brought to recover from the Collector of Internal Revenue for the District of Massa-

chusetts two separate items of taxes paid, alleging overpayment of personal income taxes for the year 1941 paid in 1942. The first item was not in dispute and is not involved in this petition, as judgment was rendered for the appellant for the same. The second item was decided by said Court of Appeals adversely to the appellant in two opinions concurring in the judgment but otherwise inconsistent.

Statement of the Case.

The facts were not in dispute. Chief Judge Magruder (R. 84-88) in his opinion repeated practically the summation of the salient facts as we ourselves set them forth in our brief as follows:

> Appellant is the senior member of the legal firm of Friedman, Atherton, King & Turner of Boston, Massachusetts. For many years he and his firm acted as attorneys in such legal matters as arose for Louis H. Wax, who was engaged in the wholesale and retail hardware business in Boston. Mr. Wax became involved in financial difficulties and in the early part of 1937 he was wiped out by a foreclosure, and many of his creditors were pressing him very hard for payment of overdue accounts. Wax owed $70,000. By letter dated March 12, 1937 (Ex. 3, R. 45), he advised his creditors that he could raise enough money to pay them 10% of their claims, in full settlement, if such a settlement could be made.
>
> Appellant, acting as attorney for Wax, assured the attorneys representing Wax's creditors that he would guarantee payment of the 10%, if acceptable. Wax had advised appellant that the necessary funds could be obtained from friends and by borrowing on a life in-

surance policy payable to his wife, which by statute was exempt from being available to creditors. The appellant made the commitment relying on Wax's assurances. On April 6, 1937, an involuntary petition in bankruptcy was filed against Wax by some small creditors. An offer of composition to carry out this settlement was then proposed by Wax in the bankruptcy proceedings, to pay the creditors the agreed 10%. By letters dated April 28, 1937 (Ex. 4, R. 46), and July 19, 1937 (Ex. 5, R. 47), appellant's firm requested the creditors to accept the composition offer and to file proofs of their claims. Appellant repeated his assurance to the creditors' attorneys that, although this was a "no assets" case, the 10% dividend would be forthcoming if accepted.

Mr. Wax refused to produce the $5000 which he had agreed he would contribute to the composition and repudiated his commitment to appellant. To make good the personal assurance which appellant had given to his fellow attorneys who had induced their clients to accept the debtor's offer of settlement (R. 28), on February 17, 1938, appellant, in compliance with the court's order (R. 27 and 29), deposited to the credit of the Clerk of the District Court $7000 in the bankruptcy case. $5000 of this was his own money. At the same time he filed a caveat with the court stating that no part of the deposit was paid or contributed by Wax. Certain lawyers representing a small minority of creditors, indulging in what appellant has characterized as pettifoggery, sought to oppose the composition, caused delays and prolonged the proceedings. The Referee took the position that appellant was under no obligation to continue a contest to have the composition confirmed and in the face of such conduct was entitled to abandon the settlement (R. 30-31). The

composition was then abandoned. On November 1, 1939, appellant filed a petition in which it was alleged that the proposed composition had been abandoned, that $5002.91 of the money which had been deposited was his own, and asked that the Receiver be ordered to return it to the appellant. After a contest extending over a period of two years of hearings and proceedings, as a matter of business judgment, when it appeared that there was a possibility of settling all contested matters and bringing the case to a final conclusion, on November 14, 1941, appellant filed an "agreement as to entry of decree" which referred to a petition filed by the Trustee in Bankruptcy for leave to compromise various controversies in the bankruptcy matter under which the appellant's $5002.91 was made a part of the bankrupt estate. The agreement recited that the sum was appellant's own money but that in connection with carrying out the compromise of all controversies in accordance with the Trustee's petition, and upon condition of the entry of a decree of the court authorizing the petition, appellant would not further oppose the entry of a decree directing that the $5002.91 be transferred to the Trustee of the bankrupt. In accordance with this agreement, appellant's "petition for return of deposit" was denied on November 14, 1941.

In his 1941 income tax return appellant claimed a deduction of $5000 by reason of the Wax bankruptcy transaction. The deduction was disallowed by the Commissioner, resulting in the assessment of the deficiency tax and interest, which was paid and recovery of which is now sought.

The claim for refund with respect to the item in issue was made in general terms. It states: ". . . the Commissioner erroneously refused to allow as a de-

duction, the sum of $5,000 lost by the taxpayer in the course of his connection with the Bankruptcy Proceedings of one Louis H. Wax . . ."

The appellant claimed that the payment was made to fulfill an undertaking to which he had personally committed himself. It was not a loan to Wax. He does not ask for a deduction for a bad debt. It was not a gift to Wax. It was not made to discharge any obligation or promise of Wax. It was paid into court as an incident of the appellant's practice of law, that when he gave his word it was good. It was a discharge of the taxpayer's own personal obligation—to live up to representations and promises he personally had made. He took upon himself all responsibility for making good a professional promise. At the time of the payment he believed Wax was honest and in one way or another would eventually make good on his word, as he had done in the past. It was on his confidence in Wax that appellant had made his personal commitment, expecting that eventually Wax would so handle the matter that the appellant would not eventually suffer a loss. Wax did not do this. The deduction is asked for as an expense or a loss incurred in the course of business, either under §23(a)(1), or §23(e)(1). The appellant's relations with Wax were wholly professional. There was no connection between them except that of attorney and client.

The Decision.

Points at Issue.

The Court of Appeals divided on the legal principles involved.

The case involves the interpretation and application of the provisions of I.R.C. §23(a)(1) and §23(e)(1). The opinion of the Court (Peters, D.J., R. 80-84) in effect held that the taxpayer had not brought himself within the provision allowing a deduction for a loss because the loss sustained was due to his "voluntary" act. The opinion of Chief Judge Magruder (R. 84-89) finds that the taxpayer would have been entitled to the deduction but lost the right to it because he did not take appeals from the Referee's adverse decision which the judge believed erroneous and suggests would have been reversed by some higher tribunal and the loss avoided.

The reasons relied on by your petitioner for issuance of said writ, and upon which your petitioner believes the writ ought to be issued, are as follows:

1. The case presents issues involving interpretation and application of provisions of the tax statutes, the correct interpretation of which is important both to the Government and to the taxpayers.
2. §23(e)(1) has never been authoritatively adjudicated by this Court or by any Court of appellate jurisdiction except in this instance.
3. The Court of Appeals' interpretation of §23(e)(1) in this litigation is clearly erroneous in that, in spite of a difference in the wording of the two sections, the decision in effect holds §23(e)(1) merely repetitious of §23(a)(1).
4. The decision is in conflict with decisions of the Courts of Appeal in other circuits under §23(a)(1) and the decision of this Court on matters herein involved is necessary so that the interpretation of the tax statute may be kept uniform throughout the various circuits.
5. The opinion of the Chief Judge introduces a new and dangerous element as a test in tax cases. It

holds that a taxpayer is not entitled to deduct a loss taken under a Court's decision if the Tax Court later thinks that decision was erroneous and could have been set aside on appeal. It errs in failing to realize that a right of appeal confers upon the litigant a privilege and does not impose a duty of appealing.

Wherefore your petitioner prays that a writ of certiorari herein issue.

LEE M. FRIEDMAN.

COMMONWEALTH OF MASSACHUSETTS.

SUFFOLK, ss. BOSTON, January 20, 1949.

Lee M. Friedman, first being duly sworn, deposes and says that he is the petitioner and a member of the Bar of this Honorable Court; that he has read the foregoing annexed petition, and knows well the contents thereof; that he also carefully had read and studied the transcript of the record which accompanies said petition, being the transcript of the record of the case at bar; that the matters in said petition contained are, in the judgment of the affiant, duly supported in and by said transcript of record and the certificate of the clerk of the District Court of the United States for the District of Massachusetts, submitted with said petition; and that he knows of the above proceedings had, and that the acts and facts in said petition stated are true to the best of his knowledge and belief.

Subscribed and sworn to before me the day and year first above written.

SIDNEY WERLIN,
Notary Public.

We do hereby each certify that we each carefully have examined the foregoing petition for a writ of certiorari; that the allegations thereof are true, as we each verily believe, and in the opinion of each of us the petition is well founded and the case is one in which the prayers of the petition should be granted by this Court.

LEE M. FRIEDMAN,
LOUIS B. KING,
Counsel for Petitioner.

Supreme Court of the United States.

OCTOBER TERM, 1948.

No.

LEE M. FRIEDMAN,
Petitioner,
v.
DENIS W. DELANEY, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MASSACHUSETTS,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The Issues Involved.

The petition has set forth the facts which were undisputed.

§23(a)(1) (as amended by the Revenue Act of 1942, c. 619, 56 Stat. 798, sec. 121), Deductions from Gross Income (26 U.S.C. 1946 at § 23), provides:

> "(a) *Expenses.*—(1) *Trade or business expenses.*
>
> "(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pur-

suit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

§23(e)(1) provides:

"(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

"(1) if incurred in trade or business; or . . ."

Argument.

I.

DIFFERENCE BETWEEN §23(a)(1) AND §23(e)(1).

§23(e)(1) has not been passed upon by this or any other Court of appellate jurisdiction for construction.

If, as generally said, §23(e)(1) is broader than §23(a)(1), then the appellant is entitled to the claimed deduction.

The Court treated §23(e)(1) as if it were mere repetition of §23(a)(1) and in no way enlarged the range of allowable deductions for an individual as specified in §23(a)(1).

The language of §23(e)(1) applies only to individuals, but, without qualifying words, it allows *all* losses suffered if incurred by an individual in trade or business. Such losses need not be the "ordinary and necessary expenses" of §23(a)(1). The only limitation imposed upon the individual allowable deductions is that they should be losses incurred in trade or business.

The term "trade or business" means any pursuit or occupation to which the appellant devotes his time and attention for the purpose of a livelihood. It necessarily includes the practice of law. This Court has said: " 'Business' is a very comprehensive term and embraces everything about which a person can be employed," and cites with approval the definition of business from Bouvier's Law Dictionary: "That which occupies the time, attention and labor of men for the purpose of a livelihood or profit."

Flint v. *Stone Tracy Co.*, 220 U.S. 107, 171.

This has been approved in later decisions.

See *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503, 514-515.

See also 12 C.J.S., "Business," pp. 761, 762, 766.

The test seems to be whether the taxpayer's activities are carried on to secure a profit. Thus a farmer who conducts his farm as a business is entitled to deduct losses while one who runs his farm as a hobby is not so entitled.

II.

"ORDINARY AND NECESSARY EXPENSES" UNDER §23(a)(1) INCURRED IN A TRADE OR BUSINESS.

The interpretation under this section of what are "ordinary and necessary expenses" incurred in a trade or business adopted by the decision of the Court of Appeals for the First Circuit is in direct conflict with decisions of other Courts of Appeals of long standing.

Dunn & McCarthy v. *Commissioner*, 139 F. (2d) 242 (C.C.A. 2).

A. Harris & Co. v. *Lucas*, 48 F. (2d) 187 (C.C.A. 5).

Helvering v. *Community Bond & Mortgage Corporation*, 74 F. (2d) 727 (C.C.A. 2).

McGee v. *Nee*, 113 F. (2d) 543 (C.C.A. 8).

See also

Miller v. *Commissioner*, 37 B.T.A. 830.

Scruggs, Vandervoorst-Barney Inc. v. *Commissioner*, 7 T.C. 779.

First National Bank of Skowhegan v. *Commissioner*, 35 B.T.A. 876, 884-886.

Camp Manufacturing Co. v. *Commissioner*, 3 T.C. 467, 472.

Catholic News Publishing Co. v. *Commissioner*, 10 T.C. 73.

Chief Judge Magruder pointed this out in his opinion (R. 86) and thinks his Court should have followed the Dunn & McCarthy and A. Harris decisions.

The instant decision introduces a new, undesirable and unwarranted test and element into what are "ordinary and necessary expenses" in business under the Internal Revenue law—namely, whether such expenses are the result of "voluntary" or "involuntary" action on the part of the taxpayer; that is, whether in the judgment of the tax authorities the loss on the part of the taxpayer was brought about by some voluntary act or non-action which he did, or refrained from doing on his own.

In a sense, in business everything which a businessman does is voluntary. There is no law or compulsion which makes him buy cotton or wool for his mill when had he

not bought he would not have suffered a loss when the market broke and prices fell. When a man drove his truck to deliver merchandise and smashed it when he was under no compulsion to make deliveries but might have waited until the buyer called for delivery, he "voluntarily" did something in his business which caused the loss.

When a businessman at the expense of his business provides recreation, vacation camps or extra attentions for his workmen which no law requires, it is all "voluntary" and is a loss or expense in his business which he could have avoided by refraining from doing what he was under no legal obligation to do.

The present decision advances the novel and unsound proposition that a business loss which is not made in consequence of a legally enforceable obligation is a "voluntary" transaction by the taxpayer and therefore not a deductible loss. It advances the theory that, if a loss in a business was due to living up to a moral obligation which the taxpayer might have avoided by breaking his word, or escaped through the use of technicalities, such as pleading the Statute of Frauds, to which he did not resort, under tax law there is no deductible loss.

Is not the test whether the taxpayer incurred the loss or expense in good faith according to his judgment of the proper way to conduct his business rather than the opinion of tax authorities or a Court as to whether the taxpayer was discharging a legal obligation or doing something he could have sidestepped and thereby saved money? Is the right of a taxpayer to a deduction for a business loss to depend on what the Government determines afterwards could have been avoided had the taxpayer not done what he had chosen to do?

III.

UNDER §23(e)(1) THE LIMITATIONS OF §23(a)(1) OF "ORDINARY AND NECESSARY" ARE ELIMINATED.

Under 23(e)(1), if there is an actual loss in the business conducted by an individual incurred in good faith, there is a deductible loss and that is all there is to it.

Its deductibility does not depend on whether Government agents later decide—

(a) That the loss could have been avoided;
(b) It was not necessary;
(c) It was not usual;
(d) It was the result of bad judgment;
(e) The loss was not the result of legal liability which he could have resisted.

IV.

JUDGE MAGRUDER'S OPINION* INTRODUCES INTO TAX DEDUCTIONS AN ERRONEOUS ELEMENT.

A most dangerous principle in federal taxation is enunciated in his opinion as the basis of Judge Magruder's

*Judge Magruder (R. 89) says: "The record contains no basis for a finding that it was part of Friedman's business as a practicing lawyer to contribute $5000 of his own money to the bankrupt estate of his client Wax in order to induce the trustee in bankruptcy to accept a compromise settlement of the claim of the estate against the Malden Trust Company." He was in absolute error and misinterpreted the record. There is not the least suggestion in the record that Friedman made a contribution to induce the Trustee to accept a compromise of the claim against the Malden Trust Company. The record only shows that in a single petition the Trustee sought authority from the Referee in Bankruptcy to settle a series of claims and suits (R. 51-53). There is no suggestion that any one of them had any relation to another, nor any suggestion that any settlement had any relation to another, or

acquiescence in the decision. It rests on the idea that the taxpayer cannot accept the decision of a Court of first instance establishing his loss if the Tax Court or another United States Court later thinks that the decision was erroneous. His opinion puts it that the taxpayer should have appealed the decision imposing the loss and won his case in some appellate jurisdiction. The logic of that position is that until the taxpayer wins or loses in the very highest Court of last resort the status of his loss is questionable and continues to be such unless a Tax Court approves as correct the decision of a lower Court deciding against the taxpayer.

This ignores that at least as to the taxpayer the trial Court's decision is *res judicata* and there is no legal nor moral obligation to continue litigation until all appeals are exhausted.

It fails to recognize that in litigation a right of appeal confers a privilege and imposes no duty upon a litigant to exercise such rights.

V.

It is respectfully submitted that the writ herein prayed should issue to the end—

1. That an authoritative decision may be had eliminating the conflict between the decision of the Court of Ap-

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depended on any other. It was just sloppy pleading and a cheap way of saving time and work to bunch together different pending controversies in which the Trustee was engaged so as to save expense of separate notifications to creditors [Bankruptcy Act §58a(6)] in asking authority from the Court to permit the settlements of independent and unrelated suits and claims. There was no basis for assuming that Friedman was interested in anything other than his $5000. Judge Magruder might just as well have assumed that Friedman was paying the $4000 mentioned as being received in compromise of some of the claims being settled. His remarks were gratuitous, without foundation, and wholly wrong.

peals for the First Circuit and those of other circuits as to the proper interpretation of §23(a)(1) of the Internal Revenue Code.

2. That a proper interpretation of §23(e)(1) may be had to avoid future miscarriages of justice under the precedent of the decision hereby challenged.

Respectfully submitted,

FRIEDMAN, ATHERTON, KING
& TURNER,
LEE M. FRIEDMAN,
LOUIS B. KING,
Counsel for the Petitioner.

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CITATIONS

826146—49

In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 538

LEE M. FRIEDMAN, PETITIONER

v.

DENIS W. DELANEY, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MASSACHUSETTS

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 8–15) is reported at 75 F. Supp. 568. The opinion of the Court of Appeals (R. 80–84) and the concurring opinion (R. 84–89) are reported at 171 F. 2d 269.

JURISDICTION

The judgment of the Court of Appeals was entered on December 13, 1948. (R. 89.) The petition for a writ of certiorari was filed on January 31, 1949. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Where taxpayer, in attempting to effect a composition of claims against his bankrupt client, assuring attorneys for the creditor and the referee in bankruptcy that the necessary $5,000 would be forthcoming and subsequently, without legal obligation, provided $5,000 from his own funds upon his client's failure to do so, was that expenditure deductible either as an ordinary and necessary business expense under Section 23 (a) (1) or as a business loss under Section 23 (e) (1) of the Internal Revenue Code?

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 23 [as amended by the Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 121]. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—(1) *Trade or business expenses.*—
>
> (A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition

to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (a)-1. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23 (b) to 23 (s), inclusive, and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. As to charitable contributions by corporations not deductible under section 23 (a), see section 19.23 (a)-13. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See section 19.22

(a)–5.) Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see section 19.23 (a)–2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. Penalty payments with respect to Federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. * * *

SEC. 19.23 (e)–1. *Losses by individuals.*—Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if (a) incurred in the taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck, or other casualty, or theft, and a deduction therefor has not prior to the filing of the return been claimed for estate tax purposes in the estate tax return, or (d) if not prohibited or limited by any of

the following sections of the Internal Revenue Code: Sections 23 (g) and 117, relating to capital losses; section 23 (h), relating to wagering losses; section 24 (b), relating to losses from sales or exchanges of property between persons designated therein; section 112, relating to recognition of gain or loss upon sales or exchanges of property; section 118, relating to losses on wash sales of stock or securities; section 251, relating to income from sources within possessions of the United States; and section 252, relating to citizens of possessions of the United States. See section 213 as to limitation upon losses sustained by nonresident aliens.

* * * * *

STATEMENT

The facts, as summarized from the stipulation and the District Court's opinion, are as follows:

Taxpayer, an attorney who has been at the bar for over fifty years, is the senior member of the Boston law firm of Friedman, Atherton, King and Turner. (R. 8, 72.) This firm was for many years counsel for one Louis H. Wax, a businessman, who was in financial difficulties in 1937. (R. 8.) On Mr. Friedman's advice, Wax proposed that his creditors accept ten cents on the dollar in settlement of their claims against him. This settlement required about $8,000, part of which was promised by and later actually paid by Wax's new employers, Messrs. Goffman and Kaufman

(doing business as "Gofkauf"), and $5,000 of which Wax proposed to realize from an insurance policy on his life, payable to his wife and not available to his creditors without her consent. (R. 8–9.) Taxpayer then told several different lawyers representing Wax's creditors about the arrangement with Gofkauf and Mrs. Wax, and states that he said to them (R. 9):

> I had that policy and I knew that I would get that money and I would see that he got the dividend if he induced his creditors to accept.

Taxpayer did not say that he would pay Mr. Wax's creditors from his personal funds, but that "he was morally certain that Mr. Wax would carry out what he said he would do." (R. 9.) Taxpayer also told the referee in bankruptcy proceedings later instituted that he was in a position to give the court the assurance that if the ten per cent composition with Wax's creditors was accepted and confirmed, then the money was available to carry it through. (R. 9.)

Ultimately, Mr. and Mrs. Wax refused to make the insurance policy available to the creditors. In February, 1938, "wholly because he had involved himself in commitments to other attorneys and to the referee", taxpayer deposited $5,000 of his own money and $2,000 from other sources, a total of $7,000, with the Clerk of Court, with a statement that no part of the deposit had been paid by Wax, and that it was not a part of Wax's

estate. (R. 9.) This caveat was not based on the ground that the deposit was special, or in escrow, but merely indicated that the money was from persons other than the bankrupt—the type of statement which might appropriately accompany a deposit of money from proceeds of an insurance policy, or from Mrs. Wax, or from any source other than the bankrupt. (R. 9–10.)

In the summer of 1938 taxpayer told Wax about the deposit, and the latter refused to reimburse him. In 1939, taxpayer filed a petition with the referee in bankruptcy to recover the $5,000, which the referee denied in 1941. (R. 10.) In his 1941 income tax return, taxpayer deducted $5,000 as a "bad debt", which it concededly is not. (Pet. 5.) The Commissioner disallowed the deduction, a deficiency of $3,411.47 was assessed and paid, and this suit for refund was timely brought by taxpayer against the Collector. (R. 10, 64, 73.)

The District Court held that the expenditure was not an ordinary and necessary expense within the meaning of Section 23 (a) (1) and was not a business loss under Section 23 (e) (1) of the Internal Revenue Code. (R. 12–15.) The District Court held further that even if any deduction were proper it would have been proper only in 1938 and not in 1941. (R. 10.) The majority opinion affirmed along the lines taken by the District Court. (R. 80–84.) The concurring opinion held that taxpayer could not prevail on the

facts since the record showed that the expenditure was not made in fulfilment of taxpayer's moral obligation as contended, but rather in connection with a compromise entered into in 1941, and not shown to have been connected with taxpayer's business. (R. 85–89.)

ARGUMENT

1. The holding of the lower court that the voluntary assumption by an attorney of an obligation which was in origin that of his client, and the subsequent payment made in accordance therewith resulted neither in a deductible business expense under Section 23 (a) (1), *supra,* nor in a deductible business loss under Section 23 (e) (1), *supra,* is clearly correct. The expenditure arose from the taxpayer's gratuitous and voluntary assurances. Though taxpayer stressed the necessity for him as an attorney to keep his word once given, the lower court properly examined the origin of the obligation, concluding that it was not part of taxpayer's business to underwrite or pay the obligation of his client. The court properly determined that such an expenditure was not "ordinary and necessary" within the meaning of Section 23 (a) (1), and further that it did not constitute a business loss under Section 23 (e) (1) of the Internal Revenue Code inasmuch as it was not incurred in taxpayer's business and was entirely voluntary and intentional. The decision of the court has the support of a wealth of au-

thority from other Courts of Appeals[1] and is in harmony with this Court's decisions in *Welch* v. *Helvering,* 290 U. S. 111, and *Deputy* v. *du Pont,* 308 U. S. 488.

2. The purported conflict between this decision and decisions of other Courts of Appeals is nonexistent. In *Dunn & McCarthy* v. *Commissioner,* 139 F. 2d 242 (C. A. 2), the court held that where taxpayer's directors were of the unanimous and good-faith opinion that a failure to repay loans obtained by its deceased president from taxpayer's top-ranking salesmen would seriously impair the attitude of the salesmen and customers toward the company, and where the facts indicated that the directors' opinion was well founded, the expenditures were deductible under Section 23 (a) (1). In *Helvering* v. *Community Bond & Mortgage Corp.,* 74 F. 2d 727, the same court held that where a taxpayer made expenditures in order to purchase the stock of an agency so that it might procure the cancelation of the agency's contract to sell the taxpayer's stock and thus avoid business losses consequent upon the agency's practices, such expenditures were deductible under Section 23 (a) (1). These cases are distinguishable from the

[1] *A. Guirlani & Bros.* v. *Commissioner,* 119 F. 2d 852 (C. A. 9); *White* v. *Commissioner,* 61 F. 2d 726 (C. A. 9); *Robinson* v. *Commissioner,* 53 F. 2d 810 (C. A. 8); *Sam P. Wallingford G. Corp.* v. *Commissioner,* 74 F. 2d 453 (C. A. 10); *Commissioner* v. *Heide,* 165 F. 2d 699 (C. A. 2); see also *W. F. Young, Inc.* v. *Commissioner,* 120 F. 2d 159 (C. A. 1); *Dresser* v. *United States,* 55 F. 2d 499 (C. Cls.).

instant case for in each of the cases the Court of Appeals was justified on the facts in concluding that the expenditures in their origin were directly and proximately related to the effectuation and preservation of the taxpayer's business; whereas in the instant case taxpayer himself characterized his assumption of a personal obligation as follows (R. 38–39):

> It was due entirely to my getting myself personally into the situation that I see now, as I look back, professionally I ought never to have done.

That the Court of Appeals for the Second Circuit did not intend to announce principles at variance with the decision in the instant case is manifested by the same court's decision in *Commissioner* v. *Heide*, 165 F. 2d 699. In *McGee* v. *Nee*, 113 F. 2d 543 (C. A. 8), the court decided only that it could not state that the finding of the trial court was clearly erroneous where the trial court had held that expenses incurred by an insurance broker in providing reinsurance for its customers, the original insurance having been placed with a company which had become insolvent, were "ordinary and necessary" expenses. In the instant case, the trial court found as a fact that the expenditure involved was not "ordinary and necessary". Moreover, the general legal principles announced by the same court in *Robinson* v. *Commissioner*, 53 F. 2d 810, with which the court did not disagree in the *McGee* case, are entirely consistent with and in

harmony with the decision in this case. As for *A. Harris & Co.* v. *Lucas,* 48 F. 2d 187 (C. A. 5), apart from the fact that that case is clearly distinguishable from the instant case, the decision was premised on the erroneous assumption that Section 23 (a) (1) should be given such broad latitude as to include expenditures which are *either* ordinary or necessary. This decision has of course been overruled in *Welch* v. *Helvering, supra.*

Thus the most that can be said for taxpayer's position is that there have been cases where expenditures have been made without legal obligation and have been held on the facts to have been directly and proximately related to the taxpayers' businesses and to have constituted "ordinary and necessary" expenses. However, as this Court stated in *Deputy* v. *du Pont, supra,* p. 496, "Review of the many decided cases is of little aid since each turns on its special facts."

3. It is not true that the court treated Section 23 (e) (1)[2] as if it were merely repetitive of Section 23 (a) (1). The court did not indicate that the sections were coextensive. The court held only that the kind of deduction sought here was allowable neither under Section 23 (a) (1)

[2] Whether or not the precise limits of Section 23 (e) (1) have been previously marked out is of no importance, since the only question presented here is whether the particular deduction claimed falls within the scope of Section 23 (e) (1). That it does not is clear.

nor under Section 23 (e) (1). The court's decision in this respect is supported by every appellate decision where the voluntary assumption and payment of another's obligation was considered under both Section 23 (a) (1) and Section 23 (e) (1). *Robinson* v. *Commissioner, supra; White* v. *Commissioner,* 61 F. 2d 726 (C. A. 9); *A. Guirlani & Bro.* v. *Commissioner,* 119 F. 2d 852 (C. A. 9); *Sam P. Wallingford G. Corp.* v. *Commissioner,* 74 F. 2d 453 (C. A. 10); *W. F. Young, Inc.* v. *Commissioner, supra.*

4. In laying emphasis on the fact that taxpayer's assumption of his client's obligation was entirely voluntary from the outset, the lower court gave expression to principles which are neither unsound nor novel. That the voluntary assumption and payment of another's obligation is not "ordinary and necessary" but is generally extraordinary, is well settled by the previously cited decisions of the Courts of Appeals and this Court. Nor is it now necessary to reexamine the proposition since this Court has carefully considered the problem in *Welch* v. *Helvering,* 290 U. S. 111. In connection with the applicability of Section 23 (e) (1) dealing with business losses, it seems manifest that, as a matter of common understanding, a business loss is an unintentional parting with something of value. It is not intentional or deliberate. *Dresser* v. *United States,* 55 F. 2d 499 (C. Cls.). Nor is it reasonable to assume that Congress intended to subsidize the magnanimity

of a taxpayer in underwriting and assuming an obligation of its client, especially where as here taxpayer has himself characterized his action as something which he ought not to have done professionally, and would not have done had it not been for his long association with the particular client. (R. 34, 38.) Moreover the position assumed by the lower court, far from being novel, as taxpayer suggests, has the support of numerous prior decisions. *Dresser* v. *United States, supra; White* v. *Commissioner, supra; W. F. Young, Inc.* v. *Commissioner, supra; Robinson* v. *Commissioner,* 53 F. 2d 810 (C. A. 8); *Sam P. Wallingford G. Corp.* v. *Commissioner, supra; A. Guirlani & Bro.* v. *Commissioner, supra.*[3]

5. In the light of the District Court's determination (R. 10–11), sustained by the Court of Appeals (R. 83) that the deduction, even if proper, would have been proper only in 1938, taxpayer could not prevail were he correct in all contentions presented to this Court. The District Court found that taxpayer had parted with and lost all control over the $5,000 in 1938, and that therefore,

[3] The lower court did not hold that no expenditure made without absolute legal obligation is deductible. It held only that under the facts in this case it was not part of taxpayer's business either to underwrite or assume his client's obligation. Taxpayer in laying emphasis here as below on the necessity for living up to his moral obligation in order to preserve his professional reputation, overlooked the fact that it was not part of his business to underwrite and assume the obligation in the first place.

being on a cash basis, he would be entitled to a deduction only in 1938, if at all. (R. 10–11.) The majority agreed with this determination. (R. 83–84.) Taxpayer has not attacked this phase of the decision.

CONCLUSION

The decision of the lower court is correct and is not in conflict with decisions of any other Courts of Appeals. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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